DRN-3982221

The complaint

Mr S has complained about the advice he received from John Joseph Financial Services Limited ("JJFS") to take out a free-standing additional voluntary contribution ("FSAVC") plan.

What happened

In November 1995 JJFS advised Mr S to take out an FSAVC plan. Mr S followed the advice and the plan started in December 1995. He was 28 years old at the time.

In 2019 Mr S complained to JJFS. He felt the plan had been mis-sold because the advisor hadn't:

- pointed out that additional voluntary contributions ("AVCs") were available
- explained that AVCs were likely to provide better value for money, and
- didn't recommend that he consider AVCs.

To resolve the matter he felt a comparison should be made between what his FSAVC plan is now worth and him buying 'added years'.

JJFS said it most likely met its regulatory obligations and that the risks, implications and alternatives to an FSAVC plan were explained to Mr S. It also said the FSAVC plan was suitable for Mr S and wasn't mis-sold. In any event, given the cost of buying the necessary added years in order for Mr S to achieve his retirement goals (JJFS calculated the initial cost would be £272.60 a month) and the long-term financial commitment involved (Mr S would have been locked into buying the added years until retirement), JJFS felt it unlikely that he would have chosen this option.

JJFS nevertheless looked at the position Mr S would now be in had he contributed to an AVC plan with lower charges. It calculated that he would have been better off by £487.44 – which it offered to Mr S in settlement of the matter.

Mr S referred the complaint to us as he remained of the view that the compensation offer should be calculated by reference to 'added years'.

What I've provisionally decided – and why

I issued a provisional decision which explained why I thought the complaint should be upheld. The relevant parts of my provisional decision are outlined below, and they form part of my final decision.

Regulatory requirements

- The advisor was an independent financial advisor ("IFA") so was required to follow the Financial Intermediaries, Managers and Brokers Regulatory Association ("FIMBRA") rules.

- In 1988 FIMBRA said that an advisor:

    - shouldn't make a recommendation unless they believed, having carried out reasonable care in forming their belief, that no transaction in any other such investment (of which they ought reasonably to be aware) would be likely to secure the objectives of the consumer more advantageously, and
    - should take reasonable care to include in any recommendation to a person, other than a professional investor, sufficient information to provide that person with an adequate and reasonable basis for deciding whether to accept the recommendation.

- The advisor therefore needed to find out how all issues applied to the FSAVC plan and the various in-house options and anything else that might have been relevant to Mr S's situation. He then needed to explicitly compare what the in-house options and what the FSAVC plan had to offer. This meant the advisor needed to look into all the in-house options and positively recommend the suitable option in Mr S's best interests.

- In May 1996 the regulator issued Regulatory Update 20 ("RU20"), which codified the procedures it expected IFAs to follow in future sales. It reiterated what FIMBRA already expected ie that the IFA should establish what in-house alternatives to the FSAVC plan were available and discuss the specific differences between them when making their recommendation. It said the discussion should include the:

    - difference in charges and expenses between the FSAVC and AVC plans
    - choice of investments
    - availability of added years and the number of years that could be purchased
    - degree of personal control and privacy
    - age at which benefits could be taken
    - degree of portability on changing jobs or becoming self-employed.

- The more general introduction to the article mentioned, amongst other things, employers being willing to match or top-up benefits. It also said that charges under an in-house AVC plan would usually be lower than those under FSAVC plans, which would likely be the greatest impact to a consumer's choice on what to buy.

- This update was issued around six months after the advice in this case. However, it outlined things IFAs should already have been taking into account before May 1996 in order to give suitable advice. The update was simply a timely reminder.

Mis-sale/unsuitable advice

- The advisor should have investigated and then set out the likely difference in charges between the FSAVC and in-house AVC over the term of the plan. For added years, he should have quantified the likely benefits from the added years at retirement and compared these with the FSAVC plan.

- There was no documentary evidence available from the time of the advice – eg meeting notes, Fact Find document, Recommendation Report – to evidence what was discussed.

- To evidence that the sale was compliant with FIMBRA's rules, JJFS pointed to its documented process for this type of advice and to other advice and checklists the advisor had used. It provided me with a checklist the advisor had completed for another customer in early 1996 in support of its argument. I thought this carried little weight because although documents like the Fact Find, Illustration and Reasons Why letter were ticked and a date was recorded for when they were sent, the checklist didn't give any indication as to what the documents actually said or, more importantly, why the advisor recommended the product he did. And even if they did, they were for a different customer.

- Given the lack of documentary evidence, there was nothing to show that:
  - the advisor investigated and clearly set out to Mr S in a meaningful way the likely difference in charges between the FSAVC and AVC plan – particularly important given what the regulator said about cost being the most important factor for consumers when deciding what product to buy
  - the advisor investigated and clearly set out to Mr S in a meaningful way the likely benefits of buying added years, or
  - the recommendation of the FSAVC plan was in Mr S's best interests.

- In itself, the fact there was no documentary evidence showing the above didn't automatically mean the FSAVC was mis-sold or that it was unsuitable. But it did make it difficult for me to conclude that the sale was compliant with the requirements at the time, or that the recommendation was suitable.

- The basis of Mr S's complaint, and therefore the essence of his testimony (which was evidence), was that the options weren't properly highlighted or explained to him in a meaningful way. Although this was Mr S's recollection from 25 years ago, I hadn't seen anything persuasive to rebut it. Accordingly, given the requirements the advisor had to adhere to, I concluded that the FSAVC plan was most likely mis-sold.

Added years

- Had all the options been outlined to Mr S in a meaningful way I thought it was most likely that he would have chosen one of the in-house options. I said that because there was nothing showing that he specifically favoured or needed the FSAVC plan eg because he wanted to invest in something specific that was only available under the FSAVC plan. I also thought it was likely – and given its offer JJFS didn't appear to dispute – that the in-house AVC plan would have been cheaper than the FSAVC plan. The question was whether Mr S would have opted for an AVC plan or bought added years.

- If a consumer remained with their employer, stayed in the pension scheme and didn't exceed the maximum years' service allowed then because of investment return rates over the years it was likely that buying added years would have produced more valuable benefits than what would have been achieved via an AVC or FSAVC plan. But this in itself didn't mean that I'd make a business calculate redress compensation on an added years basis.

- This was because a lot of what I'd said was with the benefit of hindsight. In general, at the time of the advice, buying added years would most likely have looked as being expensive compared to the projected benefits of an FSAVC or AVC plan. This was because expected investment returns were much higher in the 1990s than they are now. In this case, the documentation showed a lower estimated growth rate of 6%, a mid estimated growth rate of 9% and a higher estimated growth rate of 12%. So the majority of consumers would probably have been put off by the seemingly higher cost of added years and would be unlikely to want to spend a potentially greater monthly amount buying added years just to get the same projected benefits as they could have had from an FSAVC or AVC plan.

- With that in mind, my starting point was that most consumers at the time of the advice (ie rather than in hindsight) were unlikely to have opted to buy added years. So I would only require a business to make a comparison on the basis of the consumer buying added years if there was persuasive evidence showing that the consumer would actually have done that if they'd been given suitable advice.

- Affordability was an important consideration in this respect because, as above, buying added years committed a consumer to an increasing cost, via a percentage of their salary – usually until the scheme's normal retirement age. This compared with the possibility the consumer might not have chosen to build increases into their FSAVC contributions and/or didn't go on to make such increases – as happened here. Typically, applications for added years can't be easily or regularly stopped and re-started, unlike an AVC or FSAVC plan. This meant buying added years could become unaffordable, especially if a consumer's circumstances changed.

- Mr S defended the affordability argument by telling us he was earning £40,000 (which he said was an approximation) at the time so he could afford the payments. I had reservations about Mr S's confidence that the cost of added years wouldn't have been a problem on this basis because I thought his 'approximation' was exaggerated. I said that because the FSAVC application form asked for an estimate of Mr S's total earnings before tax and he said £27-£29,000. It also asked how much he contributed to the occupational pension and he said it was 6% (£1,379.80). By my calculations that made Mr S's basic salary £23,000 (which was supported by a payslip the advisor confirmed seeing).

- Further, as a starting point the agreed contributions into an FSAVC are often based on how much the consumer could afford at the time to 'put away' for their retirement. In this case Mr S opted for monthly contributions of £80 – which compared to the £272.60 a month JJFS said it would cost for the added years.

- Accordingly, in my opinion, there was a significant doubt as to whether Mr S could in fact have afforded the cost of buying added years.

- Mr S also said the guaranteed retirement benefits of buying added years (as opposed to benefits that are subject to investment performance) would have been attractive to him. I accepted this was likely to be the case. However, the points I'd made about paying a seemingly higher amount for the same projected benefits and about being locked into paying this amount also needed to be considered. And while Mr S might think now that the added years would have been beneficial to him, I wasn't persuaded he would have seen it that way back in 1995.

- I also thought it was significant that Mr S stopped making contributions in 2003 and never re-started them. He told us he stopped the contributions because he moved overseas and took a big pay cut, which meant he couldn't afford the monthly payments. When I asked him why he never re-started them he said he thought it was because he didn't think it was a priority.

- I appreciated that in 1995 Mr S couldn't have predicted how his career would progress and/or that the contributions to the FSAVC plan would become unaffordable. But part of his argument of why the comparison should be based on added years was that his career did progress. However, despite that progression and the corresponding increase in salary, it was never a priority for him to maximise his potential retirement benefits. And as it wasn't a priority for Mr S in later life when he was closer to retirement, it was difficult for me to conclude on the balance of probabilities that it would have been a priority for him in 1995 when he was 28.

- With all the above in mind, the evidence wasn't persuasive enough for me to conclude that Mr S would have bought added years rather than an AVC plan.

JJFS's offer

- Where I conclude that advice was unsuitable and that the consumer would/should otherwise have taken out an AVC plan, I generally tell businesses to calculate the appropriate compensation by following the regulator's FSAVC review guidance. But where the calculation requires ongoing charges in an investment-based FSAVC and AVC to be compared after 1 January 2005, the FTSE UK Private Investor Growth Total Return Index should be used from 1 January 2005.

- JJFS provided us with a spreadsheet outlining the comparisons it made. I wasn't able to the check the calculation thoroughly in such a way that I could guarantee there were no errors in it as we don't have the expertise to carry out the calculations under the FSAVC guidance using the applicable benchmarks. I could nevertheless see that the total return JJFS calculated for the AVC as of 1 June 2019 was £5,871.28 and the total return it calculated for the FSAVC on the same date was £5,383.84. And the difference of £487.44 was the amount JJFS offered Mr S in settlement of the complaint.

- However, the spreadsheet showed that JJFS used the FTSE UK Private Investor Growth Total Return Index benchmark from 1 January 2001 rather than from 1 January 2005.

- I was satisfied that JJFS had made a genuine and reasonable attempt to resolve the matter. However, Mr S rejected its offer so I was tasked with deciding what I thought JJFS should do to resolve matters. I thought the fair resolution was our usual redress (outlined below).

Summary

- For the reasons outlined above, I concluded that:

    - the FSAVC plan was most likely mis-sold as the 'in-house' options weren't properly explored and/or explained to Mr S
    - there were no grounds to require JJFS to calculate the redress compensation on an added years basis because I wasn't persuaded that Mr S would have bought added years at the time of the advice
    - JJFS's offer wasn't in line with the redress I normally awarded in this type of complaint.

Responses to my provisional decision

Mr S said he had nothing further to add.

JJFS didn't have any comments on my provisional decision. However, it corrected its previous calculation of the cost of buying added years – its revised calculation was £204.45 a month initially, rising to an estimated £531.00 a month before Mr S's planned retirement. It didn't think this would have any effect on my decision. And it remained of the view that Mr S wouldn't have chosen to buy added years.

What I’ve decided – and why

I’ve considered all the available evidence and arguments to decide what’s fair and reasonable in the circumstances of this complaint.

I thank JJFS for providing further calculations for the cost of buying added years. However, as it anticipated, I don’t think this changes my provisional conclusion. That’s because, even with the lower initial cost, it remains my view that:

- the starting position should be that Mr S most likely wouldn’t have chosen to buy added years
- there were doubts as to whether Mr S could have afforded to buy added years, and
- it’s likely that maximising his retirement income was a priority for him at the timer.

It therefore remains my view that had JJFS properly set out all the options Mr S most likely would not have chosen to buy added years.

As there are no further comments or points for my to consider, my final decision remains as outlined in my provisional decision – for the same reasons.

Putting things right

JJFS should undertake a redress calculation in accordance with the regulator’s FSAVC review guidance, incorporating the amendment below to take into account that data for the CAPS ‘mixed with property’ index isn’t available for periods after 1 January 2005.

The FSAVC review guidance wasn’t intended to compensate consumers for losses arising solely from poor investment returns in the FSAVC funds, which is why a benchmark index is used to calculate the difference in charges and (if applicable) any loss of employer matching contributions or subsidised benefits.

In my view the FTSE UK Private Investor Growth Total Return Index provides the closest correlation to the CAPS ‘mixed with property’ index. So where the calculation requires ongoing charges in an investment-based FSAVC and AVC to be compared after 1 January 2005, JJFS should use the CAPS ‘mixed with property’ index up to 1 January 2005 and the FTSE UK Private Investor Growth Total Return Index thereafter.

If the calculation demonstrates a loss, the compensation amount should if possible be paid into Mr S’s pension plan. The payment should allow for the effect of charges and any available tax relief. The compensation shouldn’t be paid into the pension plan if it would conflict with any existing protection or allowance.

If a payment into the pension isn’t possible or has protection or allowance implications, it should be paid directly to Mr S as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid in retirement. 25% of the loss would be tax-free and 75% would have been taxed according to his likely income tax rate in retirement – presumed to be 20%. So making a notional deduction of 15% overall from the loss adequately reflects this.

My final decision

I uphold this complaint. I require John Joseph Financial Services Limited to settle the matter as outlined under the ‘Putting things right’ heading above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr S to accept or reject my decision before 4 April 2023.

Paul Daniel
Ombudsman